



# ITG News

Keeping First Nations Informed



Publication 4267F

Catalog Number 37843F

Southwest - Four Corners - Edition

April 2004

## Message From The Director

Many of you have probably read about the growth in abusive schemes that began two decades ago with what we now call "tax shelters". While the IRS was successful in addressing those initial schemes, we are now experiencing a new generation of individuals promoting opportunities to avoid taxes through structured transactions that "sound too good to be true" and often are.

Unfortunately, Indian tribal governments are not immune from these promoters. In fact, tribal governments have recently helped the IRS identify several promoters that are attempting to use tribal sovereignty and some of the special tax benefits that tribes enjoy, to enrich a select group of individuals they represent. These promoters may offer the tribe a limited benefit that is marketed as being at no cost or risk to the tribe. In some cases the promoters of these schemes may be invisible to tribal leadership, since they hide behind shell corporations and/or attempt to conduct transactions directly with tribal employees.

The simple fact is that these schemes do bring risk to the tribe. Even where there may be no direct financial risk, the risk to the tribe's reputation is significant and the risk to any tribal employee who becomes involved in such a scheme can be substantial.

The office of Indian Tribal Governments has initiated a program to work with tribes to address this area and ensure that these abusive schemes do not gain a foothold in Indian Country. Our Abuse Detection and Prevention Team (ADAPT) is already developing actions to identify abusive schemes being promoted to tribes, and is working with tribes to address them. Our goal is to protect the interests of all governments through mutual actions that will eliminate these schemes. Our web site will contain information on identified schemes, as well as a method to report any concerns to the ADAPT group. We look forward to partnering with tribes and other interested parties in this effort.

*Christie Jacobs*



### Inside this issue:

Message from the Director	1
Tip Reporting Agreements:	2
Update on Consultation Policy	3
Tribal Enterprise Structure Issue	3
Tax Incentives: Promotes Jobs Creation	4
Low Income Housing Credit IRC Sect 42	5
Tax Incentive for Tribal Government: Issuance of Tax-Exempt Bonds	5
Announcement 2004-2: New Code W for the 2004 Form W-2, Box 12	6
Notice 2003-37 Clarification : issuance of Forms 1099 for credit card payments	6
Tax Calendar for 2nd Quarter	7-8

To add your name or e-mail address to our mailing list, please contact us via e-mail at [Michelle.L.Risk@irs.gov](mailto:Michelle.L.Risk@irs.gov), or call Michelle L. Risk at (602) 207-8682 or (520)670-4700 ext. 227.



## **Tip Reporting Agreements: Minimizing Financial Risk**

Many tribes have enterprises that employ individuals who receive tip income. These tribal enterprises range from food service establishments to some of the largest casinos in the world. Handling large sums of cash presents many risks, and tribes go to great lengths to minimize any risk of loss.

Unfortunately some tribes have not taken steps to minimize risk that can be present from unreported tip income. Employees who do not fully report their tips to their employer can create a future tax liability for both themselves and their employer. If unreported tip income is discovered as a result of an IRS examination, both the employee and employer could face significant assessments of tax, penalties, and interest. These assessments can be particularly troublesome for the employer, who generally has not anticipated the liability.

In order to reduce the potential for unreported tip income, the IRS has developed a Tip Compliance Program. This program combines employee education with a written agreement that calculates tip rates by occupations and work shifts. Employees are openly encouraged to participate in the program. As part of the agreement, the IRS guarantees that it will not examine tip income reporting by those employees as long as they report tips at or above the established rates. Two variations of these agreements are available – the Tip Rate Determination Agreement (TRDA), and the Gaming Industry Tip Compliance Agreement (GITCA). Interested employers have their choice between the two.

The elimination of risk was realized by one tribal casino that had entered into an agreement. The amount of tip income being reported by their employees rose by over 400% subsequent to the agreement. By entering into the agreement, the casino eliminated a potential unforeseen liability of \$1.5 million dollars per year. While they paid FICA tax on the additional tips being reported, that liability could be predicted and planned. This enabled them to adequately forecast their revenues and expenses, with a significant reduction to future risk of further tax assessments. Similar benefits exist for employees. One benefit is that they will not be examined on tip income. They also receive a full and accurate reporting of their income, which can be a benefit for programs that are based on income levels. This includes pensions, 401(k) plans, and loans.

If your tribe has employees who report tips, and you have not joined our Tip Compliance Program, we encourage you to contact your Indian Tribal Governments Specialist.

???Questions???

Contact your ITG Specialist, or our toll-free call site at 877-829-5500



## Update on the Development of an IRS/Tribal Consultation Policy

We continue to move forward in the process to develop an IRS/Tribal Consultation Policy, having completed 12 regional listening meetings with tribal representatives during 2003. A summary of the input received at those meetings was posted to the ITG web site at [www.irs.gov/tribes](http://www.irs.gov/tribes) in January, with a link to submit any further comments. Once the period for submitting further input has passed, we will undertake an initial draft that will be further shared for comment. It is our hope to have a final draft policy for review by late 2004.

We welcome your input, so that we can create the best possible policy. Visit our web site at [www.irs.gov/tribes](http://www.irs.gov/tribes) to review the input to date and offer us your thoughts before April 30<sup>th</sup>.

## Tribal Enterprise Structure Issues

We have recently encountered several situations where tribes have formed business structures that may unnecessarily subject their earnings to federal income tax. While federally recognized Indian tribes are not subject to federal income tax, if they form a state-chartered corporation that is not specifically exempted from income tax under the Internal Revenue Code (such as IRC 501(c)(3) entities), the entity must file a Form 1120 and pay federal income tax on any net earnings.

In addition, we have encountered situations where tribes have formed subchapter S corporations, where the tribe is a shareholder. While the Service may acknowledge this status and process the resultant Form 1120-S that is filed, the simple fact is that tribes cannot be shareholders in subchapter S corporations. Once these situations are discovered, the entity must be converted to a C corporation, and the resultant Form 1120 will subject the tribe to federal income tax on any net earnings.

If you have either of these situations present within your tribal enterprises, and you wish to restructure them to mitigate the potential tax problem, you should contact your ITG Specialist so that we can take prompt action to effect corrections and limit any potential interest and penalties. In addition, the sooner that a problem is identified, the sooner that you can change the structure of the entity to avoid the future federal tax consequences.

## Tribal Employment Tax Guide Now Available

Publication 4268, our on-line Employment Tax Guide for Tribal Governments, is now available at our web site at [www.irs.gov/tribes](http://www.irs.gov/tribes).



## Tax Incentives: Promotes Job Creation on Reservation Lands

Expanding business development and commerce can lead to greater job opportunities for residents and to improved access to goods and services for individuals. There are some federal tax incentives that can be utilized by businesses operating on Indian reservations.

Tax incentives available to businesses operating in Indian Country are discussed further in Publication 954, Tax Incentives for Distressed Communities. You may request copies by calling 1-800-829-FORM or the publication may be downloaded from our website at [www.irs.gov](http://www.irs.gov). Generally, businesses operating in the Southwest may qualify for one or more of the tax provisions listed below.

- The Work Opportunity Credit provides businesses with an incentive to hire individuals from groups that have a particularly high unemployment rate or other special employment needs.
- The Welfare-to-Work Credit provides businesses with an incentive to hire long-term family assistance recipients.

People hired from these groups are usually entry-level workers. Employers who hire these workers can make a difference in the tribal communities.

- A tax incentive that works well for labor-intensive businesses is the Indian Employment Tax Credit. This credit provides businesses with an incentive to hire and retain individuals who live on an Indian reservation if "qualified wages" are paid to "qualified employees". Qualified employees must be:
  - 1) enrolled members of a tribe or the spouse of an enrolled member,
  - 2) work on the reservation, and
  - 3) live on the reservation (or near in Alaska and Oklahoma)
- Businesses may be able to claim Section 179 deduction of as much as \$102,000 (for tax year 2004) instead of recovering the cost by taking depreciation deductions over a specified recovery period. This additional deduction can be claimed on certain qualifying property such as equipment and machinery that would otherwise begin depreciation in the year they placed it in service. There are limits to the deduction and the kinds of property that may be expensed has restrictions.
- Special depreciation rules apply to qualified property that businesses place in service on an Indian reservation after 1993 and before 2005. These special rules allow a business to use shorter recovery periods to figure the depreciation deduction for qualified property. As a result, the depreciation deduction is larger.

If you would like to encourage economic development in your area, you should make prospective business owners aware of tax incentives that are designed to encourage them to invest. You may call your assigned specialist, if you have any questions.



## Low-income Housing Tax Credit, Internal Revenue Code Section 42

The low-income housing tax credit encourages new construction and rehabilitation of existing rental housing for low-income households and increases the amount of affordable rental housing for households whose income is at or below specified income levels. Congress has authorized the states to allocate tax credits to qualifying housing projects. The credits may be shared among the owners of a project (the equity investors) to cover the costs of developing and operating the project and provide to a return to investors sufficient to attract the equity investment needed for development. The states have been delegated the responsibility for determining the housing needs and costs. The state tax credit agencies are required to have an allocation plan that identifies the state's priority housing needs and contains selection criteria for awarding credits to help meet those needs. The tribal housing authority can administer and coordinate such a venture.

After the state allocates tax credits to developers, the developers typically sell the credits to private investors. The private investors use the tax credits to offset taxes otherwise owed on their tax returns. The tribe benefits by providing low-income housing to families living on their land.

Generally, owners must place the projects in service within 2 years of carryover allocation or return the credits to the state for reallocation to other projects. Once projects have been placed in service, state agencies are also responsible for monitoring the projects for compliance with federal requirements concerning household income, rents, and projects habitability.

## Tax Incentive for Tribal Governments: Issuance of Tax-exempt Bonds

Tax-exempt financing provides significant economic benefits through interest cost savings on tribal government debt due to the relative difference in interest rates on taxable and tax-exempt debt. Tax-exempt bonds are subject to numerous federal tax laws including requirements related to the issuance of bonds, the use of bond proceeds and financed property, as well as the temporary investment of bond proceeds. Indian tribal governments may take advantage of tax-exempt financing for two defined purposes.

**First, tribal governments may issue tax-exempt bonds to finance certain essential governmental functions.** An essential governmental function generally includes only those functions customarily performed by States and local governments with general taxing powers. Projects or activities with commercial aspects will generally not be treated as an essential governmental function. Tax-exempt bonds financing this purpose must comply with all applicable federal tax law, including applicable provisions under sections 103, 7871(c) through (e), 148, 149, and 150 of the Code.

**Secondly, tribal governments may also issue tax-exempt bonds to finance certain manufacturing facilities which are located on tribal lands and provide employment to enrolled members and their spouses.** Tax-exempt bonds financing this purpose must comply with all applicable federal tax law, including applicable provisions under sections 103, 7871(c) and (d), 144(a), 147, 148, 149, and 150 of the Code.

For more information on the requirements applicable to tax-exempt bonds or to discuss technical issues, please contact your ITG Specialist for a resource in the office of Tax Exempt Bonds. Any tribe considering the issuance of tax-exempt bonds to finance an "essential governmental function" that has commercial aspects should request the IRS office of Chief Counsel to give clearance in a private letter ruling.



## Announcement 2004-2: New Code W for the 2004 Form W-2, Box 12

A new code (Code W-Employer's contribution to an employee's Health Savings Account (HSA)) for use in box 12 on the 2004 Form W-2 has been added to the 2004 Instructions for Forms W-2 and W-3.

The Medicare Prescription Drug Improvement and Modernization Act of 2003 requires reporting of an employer's HSA on Form W-2. The amount of an employer contributes to an employee's HSA will be shown in box 12 of Form W-2, using Code W. This will include the amounts used for medical and health insurance premiums.

Generally, employer contributions to an employee's MSA are not subject to income, social security/Medicare or Railroad Retirement taxes and will not affect amounts otherwise reported in boxes 1, 3, and 5 of Form W-2.

## Notice 2003-37 Clarification: Issuance of Forms 1099 for credit card payments

**Did Notice 2003-37 change anything regarding the issuance of Forms 1099?** The answer is a resounding NO. Internal Revenue Code section 6041A(a) generally requires the payor to file and furnish an information statement to the service provider for payments of \$600 or more for services provided during any calendar year.

The method of the payment is not a factor in determining whether a Form 1099 should be issued. It was generally believed that payments via credit cards were only be made to corporations. In the electronic age, many small business are also receiving payments via credit cards. Notice 2003-27 merely stated that Merchant Category Codes (MCCs) can be relied upon for determining whether a Form 1099 should be issued to the vendor.

Many would question as to why is this a concern to the Indian tribes in the Southwest region? In the next several months, the ITG Specialists are being assigned information examinations to determine whether tribes are properly reporting the Forms 1099 to their service provider vendors who are not corporations.

What steps should the tribes take to eliminate any potential Form 1099 penalties from being asserted:

- Set up a policy to fax and secure Form W-9 from all vendors classified under the MCC as a service provider.
- If the Form W-9 is not returned establishing the service provider vendor is a corporation, then issue the Form 1099 and submit a Form W-9 to the vendor along with the payment.
- If the vendor does not complete and return the Form W-9 to you with their tax identification number, then begin back-up withholding procedures all on future payments to that vendor.
- If the vendor is a corporation or vendor is not subject to back-up withholding, then the Form W-9 should be returned to your office and the Form 1099 can be voided and the tribal office will have documentation that the Form 1099 is not required to be issued to the service provider.

As always if you have any additional questions, please contact your assigned ITG Specialist for clarification or future assistance on this or any other issue.





# Federal Tax Calendar for Second Quarter 2004

## April 2004

SUN	MON	TUE	WED	THU	FRI	SAT
				1	2 * Payroll date 3/27-3/30	3
4	5	6	7 * Payroll date 3/31-4/2	8	9 * Payroll date 4/3-4/6	10
11	12 Employees report tips from March	13	14 * Payroll date 4/7-4/9	15 ** Monthly Deposit for March	16 * Payroll date 4/10-4/13	17
18	19	20	21 * Payroll date 4/14-4/16	22	23 * Payroll date 4/17-4/20	24
25	26	27	28 * Payroll date 4/21-4/23	29	30 * Payroll date 4/24-4/27	

## May 2004

SUN	MON	TUE	WED	THU	FRI	SAT
						1
2	3	4	5 * Payroll date 4/28-4/30	6	7 * Payroll date 5/1-5/4	8
9	10 Employees report tips from April	11	12 * Payroll date 5/5-5/7	13	14 * Payroll date 5/8-5/11	15
16	17 ** Monthly deposit for April	18	19 * Payroll date 5/12-5/14	20	21 * Payroll date 5/15-5/18	22
23	24	25	26 * Payroll date 5/19-5/21	27	28 * Payroll date 5/22-5/25	29
30	31					

\*= Make a Payroll Deposit if you are under the semi-weekly deposit rule. \*\* = Make a Monthly Deposit if you qualify under that rule.

NOTE: Deposits made through EFTPS are due one day prior to the dates listed.



## June 2004

SUN	MON	TUE	WED	THU	FRI	SAT
		1	2	3 * Payroll date 5/26-5/28	4 * Payroll date 5/29-6/1	5
6	7	8	9 * Payroll date 6/2-6/4	10 Employees report tips from May	11 * Payroll date 6/5-6/8	12
13	14	15 ** Monthly deposit for May	16 * Payroll date 6/9-6/11	17	18 * Payroll date 6/12-6/15	19
20	21	22	23 * Payroll date 6/16-6/18	24	25 * Payroll date 6/19-6/22	26
27	28	29	30 * Payroll date 6/23-6/25			

\*= Make a Payroll Deposit if you are under the semi-weekly deposit rule. NOTE: Deposits made through EFTPS are due one day

### Return Filing Dates

#### By April 30th

File Form 941 for the first quarter of 2004. If the tax was deposited in full and on time, file by May 10th.

File Form 730 on applicable wagers accepted during March 2004.

#### By June 1st

File Form 730 for applicable wagers accepted during April 2004.

#### By June 30th

File Form 730 for applicable wagers accepted during May 2004.